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In the Supreme Court of the United States

OCTOBER TERM, 1993

O'MELVENY & MYERS, PETITIONER

v.

**FEDERAL DEPOSIT INSURANCE CORPORATION
AS RECEIVER FOR AMERICAN DIVERSIFIED SAVINGS
BANK, ET AL.**

**ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

**BRIEF FOR THE
FEDERAL DEPOSIT INSURANCE CORPORATION**

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QUESTION PRESENTED

The Federal Savings and Loan Insurance Corporation, acting as receiver for a failed federally insured savings institution, brought suit against a law firm ^{for} giving negligent legal advice to the institution before its insolvency. The law firm seeks to defend the suit on the ground that the savings institution itself would be barred from suit because the conduct of its wrongdoing officers (who retained the law firm) would be imputed to it. The question presented is whether this wrongdoing is also to be imputed to the receiver so as to bar it from pursuing claims against the law firm for damage caused to the bank's financial condition by the firm's professional malpractice.

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No. 93-489

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-16a) is reported at 969 F.2d 744. The opinion of the district court (Pet. App. 17a-19a) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on June 29, 1992. A petition for rehearing was denied on June 30, 1993. Pet. App. 22a. The petition for a writ of certiorari was filed on September 27, 1993. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

(1)

STATEMENT

1. This case arises out of the failure of American Diversified Savings Bank (ADSB), a federally insured financial institution; petitioner provided legal services to that institution before it failed. On February 14, 1986, the Federal Savings and Loan Insurance Corporation (FSLIC) became conservator for ADSB. Five days later it filed a lawsuit in federal court alleging that Ranbir Sahni and Lester Day (the Chief Executive Officer and President, respectively, of ADSB) had breached fiduciary duties to the institution in connection with two securities offerings, and that Day's conduct amounted to racketeering violations. Subsequently, the offerings were rescinded and the investors were repaid the sums they had invested. On May 12, 1989, FSLIC filed this suit against petitioner, charging that petitioner's representation of the institution in connection with the offerings had been negligent and involved a breach of fiduciary duty; FSLIC sought to recover from petitioner the funds the institution lost as a result of the rescinded offerings. See Pet. App. 1a-5a; Pet. 3.

2. The district court granted summary judgment in favor of petitioner and against the Federal Deposit Insurance Corporation (FDIC),¹ apparently reasoning that petitioner's only duty was to the investors, and that the repayment of the investors absolved petitioner of further liability. Pet. App. 17a-19a.

3. The court of appeals reversed. Pet. App. 1a-16a. The court first rejected the district court's under-

¹ FSLIC became receiver in 1988. The FDIC succeeded FSLIC as receiver by operation of law on August 10, 1989. 12 U.S.C. 1821a(a)(5)(A) (Supp. IV 1992).

standing of petitioner's duty of care, *id.* at 6a-9a, stating that an attorney under California law has a duty "to protect the client from the liability which may flow from promulgating a false or misleading offering to investors," *id.* at 8a. In the court's view, the FDIC's allegations raised a question of fact regarding petitioner's compliance with that duty. *Id.* at 9a.

The court then considered petitioner's argument that the FDIC was estopped from bringing this action because insiders of the failed institution (Sahni and Day) were aware of the wrongdoing, and because their knowledge must be attributed to the institution and then, in turn, to the FDIC. Pet. App. 9a-15a. The court first concluded that the knowledge of the malfeasant officers should not be attributed to the institution "if a recovery by the plaintiff would serve the objectives of tort liability by properly compensating the victims of the wrongdoing and deterring future wrongdoing." *Id.* at 12a.² The court then held, in the alternative, that even if the knowledge of the malfeasant officers were to be attributed to the institution, that knowledge would as a matter of federal law not estop the FDIC as receiver. *Id.* at 13a-15a. The court noted that the FDIC "was neither

² The court of appeals did not analyze the choice-of-law question on this issue. The primary authorities on which it relied in this portion of its opinion, however, were based on federal law and the law of States other than California. See Pet. App. 11a-12a (citing *Schacht v. Brown*, 711 F.2d 1343 (7th Cir.), cert. denied, 464 U.S. 1002 (1983); *Cenco, Inc. v. Seidman & Seidman*, 686 F.2d 449 (7th Cir.), cert. denied, 459 U.S. 880 (1982); and *In re Investors Funding Corp.*, 523 F. Supp. 533 (S.D.N.Y. 1980)).

a party to the original inequitable conduct nor is it in a position to take action prior to assuming the bank's assets to cure any associated defects." *Id.* at 14a.

Hence, the court reasoned, "imputing the bank's inequitable conduct to the receiver" would "frustrate[]" the statutory scheme "[b]y diminishing the value of the asset pool held by the receiver and limiting the receiver's discretion in disposing of the assets." *Id.* at 15a.

ARGUMENT

For the reasons summarized in the petition we are filing today in *FDIC v. Shrader & York*, we believe that the decision of the court of appeals in this case is correct.³ Under federal law, which governs defenses in cases brought by the FDIC as receiver for failed financial institutions, the wrongdoing of insiders is, as the Ninth Circuit has held, not to be attributed to the FDIC so as to bar its suits on behalf of creditors the institution, and the public.

We agree with petitioner, however, that the holding of the court of appeals here conflicts with the contrary law of the Fifth Circuit as established in the *Shrader & York* case and in *FDIC v. Ernst & Young*, 967 F.2d 166 (1992). Furthermore, the question is of profound importance to the FDIC. The FDIC manages the estates of literally hundreds of failed financial institutions, and in a substantial portion of those cases is pursuing claims that malfeasance by insiders—frequently aided by law firms and other third parties, as in this case and in *Shrader & York*—

³ We have provided counsel for petitioner a copy of our petition in *Shrader & York*.

contributed to the failure of the institution. The sums of money at stake are enormous; the FDIC estimates that it is pursuing similar claims in amounts that exceed \$1.5 billion. If the wrongdoing of insiders that takes place before insolvency is to be attributed to the FDIC when it subsequently becomes receiver, that effectively will bar recovery in these cases.

Hence, as we state in the petition in *Shrader & York*, we believe that it would be appropriate for the Court to grant the petition in this case in order promptly to resolve this important issue.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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